(6) (5)

Nos. 87-826, 87-1101

In The

Supreme Court of the United States

October Term, 1987

Jerome F. Goldberg and Robert McTigue,
Appellants,
v.

Roger D. Sweet, Director of the Illinois Department of Revenue, *et al.*,
Appellees.

GTE Sprint Communications Corporation,
Appellant,
v.

Roger D. Sweet, Director of the Illinois Department of Revenue, *et al.*,
Appellees.

On Appeal from the Supreme Court of Illinois

BRIEF FOR APPELLANTS GOLDBERG AND McTIGUE

Walter A. Smith, Jr.*
John G. Roberts, Jr.
Hogan & Hartson
(a partnership including professional corporations)
555 Thirteenth Street, N.W.
Washington, D.C. 20004
(202) 637-6448

John G. Jacobs
Jonah J. Orlofsky
Plotkin & Jacobs, Ltd.
116 South Michigan Avenue
Suite 1300
Chicago, Illinois 60603
(312) 372-0001

Counsel for Appellants

Of Counsel:

William G. Clark, Jr.
William G. Clark, Jr. & Associates, Ltd.
29 South LaSalle Street
Chicago, Illinois 60603
(312) 263-0830

* Counsel of Record

Wilson - Epes Printing Co., Inc. - 789-0096 - Washington, D.C. 20001

4417

QUESTION PRESENTED

May a State, consistent with the Commerce Clause, impose a tax on interstate telecommunications that is completely unapportioned, that subjects the telecommunications to multiple state taxation, that increases as the State's contact with the telecommunications decreases, and that lays a heavier burden on interstate telecommunications than intrastate telecommunications?

PARTIES TO THE PROCEEDINGS

Appellants Jerome F. Goldberg and Robert McTigue, plaintiffs before the Cook County Circuit Court and appellees before the Illinois Supreme Court, are residents of Illinois subject to the challenged state tax. Appellee Roger D. Sweet succeeded defendant J. Thomas Johnson as Director of the Illinois Department of Revenue. Appellee Jerry Cosentino succeeded defendant James H. Donnewald as Treasurer of the State of Illinois.

The following telecommunications companies were also named as defendants in the complaint: GTE Sprint Communications Corporation ("GTE Sprint"), MCI Telecommunications Corporation ("MCI"), Satellite Business Systems ("SBS"), Republic Telecom Corporation, U.S. Telecom Communications Services Company, American Telephone and Telegraph Company, Allnet Communications Services, Inc., Electronic Office Centers of America, Inc., Lexitel Corporation, Illinois Bell Telephone Company, International Telephone and Telegraph Corporation, TDX Systems, Inc., TMC Long Distance, and Western Union. GTE Sprint, MCI, and SBS filed counterclaims alleging that the tax at issue was unconstitutional; GTE Sprint also participated as an appellee before the Illinois Supreme Court.

GTE Sprint filed a separate notice of appeal to this Court, and a separate jurisdictional statement (No. 87-1101). This Court noted probable jurisdiction over both appeals, and consolidated them. 108 S. Ct. 1010 (1988).

TABLE OF CONTENTS

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

Nos. 87-826, 87-1101

JEROME F. GOLDBERG AND ROBERT MCTIGUE,
Appellants,
v.

ROGER D. SWEET, DIRECTOR OF THE ILLINOIS DEPARTMENT OF REVENUE, *et al.,*
Appellees.

GTE SPRINT COMMUNICATIONS CORPORATION,
Appellant,
v.

ROGER D. SWEET, DIRECTOR OF THE ILLINOIS DEPARTMENT OF REVENUE, *et al.,*
Appellees.

On Appeal from the Supreme Court of Illinois

BRIEF FOR APPELLANTS GOLDBERG AND McTIGUE

OPINIONS BELOW

The opinion of the Supreme Court of Illinois is reported at 117 Ill.2d 493, 512 N.E.2d 1262, and is reprinted in the appendix to the Goldberg Jurisdictional Statement ("GA") at 4a.

The findings of fact and conclusions of law of the Circuit Court of Cook County (Curry, J.) are unreported and are reprinted at GA 20a.

JURISDICTION

Appellants Goldberg and McTigue filed suit against state officials and various long distance telephone carriers in the Circuit Court of Cook County, Illinois on August 13, 1985, contending that the Telecommunications Excise Tax Act, Ill. Rev. Stat. ch. 120, ¶¶ 2001-2021, contravened, *inter alia*, the Commerce Clause of the United States Constitution, U.S. Const. Art. I, § 8, cl. 3, as well as the Due Process and Equal Protection Clauses. On October 8, 1985, defendant GTE Sprint Communications Corporation ("GTE Sprint") filed a cross-claim against the Director of Revenue, also alleging that the Act was unconstitutional under the Commerce Clause. On October 21, 1986, the Circuit Court (Curry, J.) granted motions for summary judgment in favor of appellants, ruling that the Act violated both the Commerce Clause and Equal Protection Clause of the United States Constitution. GA 18a-24a. The Director of Revenue appealed, and on June 24, 1987, the Illinois Supreme Court issued an order reversing the Circuit Court. GA 17a. On July 27, 1987, the Illinois Supreme Court issued a *per curiam* opinion with respect to its order, GA 4a, and on October 5, 1987, denied a timely-filed petition for rehearing. GA 3a. On October 26, 1987, the Goldberg appellants filed their notice of appeal with the Illinois Supreme Court, GA 1a, and on December 8, 1987, GTE Sprint filed its notice of appeal. *See* GTE Sprint Jurisdictional Statement Appendix ("GTE A") 1a. On February 22, 1988, this Court noted probable jurisdiction and consolidated the Goldberg appeal (No. 87-826) and GTE Sprint appeal (No. 87-1101). Pursuant to a request by GTE Sprint, the time for filing the briefs for appellants was extended to and including April 29, 1988. The jurisdiction of this Court over the appeals rests on 28 U.S.C. § 1257(2).

PERTINENT CONSTITUTIONAL AND STATUTORY PROVISIONS

The Commerce Clause of the United States Constitution, Art. I, § 8, cl. 3, provides in pertinent part that "The Congress shall have Power * * * to regulate Commerce * * * among the several States * * *."

The full text of the Telecommunications Excise Tax Act, Ill. Rev. Stat. ch. 120, ¶¶ 2001-2021, is set forth at GA 25a-47a.

STATEMENT OF THE CASE

Section four of the Illinois Telecommunications Excise Tax Act ("the Act") took effect on August 1, 1985, and imposed a tax "upon the act or privilege of originating in this State or receiving in this State interstate telecommunications * * *." Ill. Rev. Stat. ch. 120, ¶ 2004; GA 29a. The tax is assessed at a flat rate of five percent "of the gross charge for such telecommunications purchased at retail," *id.*, and applies to all calls charged to an Illinois service address, regardless of where the calls are billed or paid. *Id.*, ¶ 2002(a), (b); GA 25a, 26a. The retailer of the calls is required to collect the tax from the person who is charged for the call, and the amount "required to be collected * * * constitute[s] a debt owed by the retailer to [the] State." *Id.*, ¶ 2005; GA 30a.[1] The Act further provides that, "whenever possible," the tax is to be stated as a separate item from the gross charge for telecommunications. *Id.*

In addition to the five percent tax on interstate telecommunications, the Act also imposes a tax on intrastate telecommunications, again at a flat rate of five percent of the gross retail charge. *Id.*, ¶ 2003; GA 29a. Thus, a call that is placed, transmitted, and received entirely in

---

[1] Hence, because GTE Sprint failed to set up its billing system by the effective date of the Act so as to be able to collect the tax from its customers, GTE Sprint itself was required to pay some $400,000 in taxes due under the Act. GTE A 10a.

Illinois is taxed at five percent. Similarly, a call placed and charged in Illinois that is transmitted outside Illinois and received in Indiana is still taxed at five percent of the cost of the entire call. If the call is placed to Hawaii, or received in Illinois collect from Hawaii, Illinois again taxes five percent of the total cost of the call.

The section of the Act taxing interstate calls contains a "credit" provision, the stated purpose of which is "[t]o prevent actual multi-state taxation." *Id.*, ¶ 2004; GA 29a. The provision "allow[s]" an Illinois taxpayer a credit against the five percent charge paid to Illinois, provided he proves that he paid another State a tax on the same "event" taxed by Illinois, and that the other State's tax was "properly due." The statute contains no procedures for actually obtaining such a "credit," nor any standards for the requisite proof that the tax paid to the other State was in fact "properly due" and that the other State's tax was imposed on the same "event" taxed by Illinois.

Appellants Jerome F. Goldberg and Robert McTigue, Illinois residents who are subject to and have paid Illinois' five percent tax on interstate telecommunications, filed a class action complaint on August 13, 1985, in Cook County Circuit Court, naming as defendants the Director of the Illinois Department of Revenue and various long-distance telephone carriers (including GTE Sprint) tasked with collecting the tax. The complaint sought a declaration that section four of the Act violated, *inter alia*, the Commerce Clause, the Due Process Clause, and the Equal Protection Clause of the United States Constitution. Goldberg and McTigue also sought an injunction against continued collection of the tax, and an accounting and refund of taxes already collected in violation of the Constitution.

Several of the long-distance carriers (including GTE Sprint) responded by filing cross-claims of their own (denominated "counterclaims") against the Director,

likewise seeking a declaration that the tax on interstate telecommunications was unconstitutional. Appellants thereafter obtained orders, pursuant to Illinois law,[2] requiring that all monies collected in the State by all defendant long-distance carriers be remitted under protest and retained in a special fund. At the time judgment was entered by the court below, there were over 142 million dollars in the protest fund,[3] and payments have continued to be made into it at the rate of approximately ten million dollars per month.

Acting upon cross-motions for summary judgment, the Circuit Court concluded that section four was unconstitutional. In reaching that conclusion, the court first rejected the State's argument that the tax did not implicate the Commerce Clause because it was imposed only on a local purchase or sale. Specifically, the court held

[2] The State Officers and Employees Money Disposition Act, Ill. Rev. Stat. ch. 127, ¶ 172.

[3] Six days after the Illinois Supreme Court entered the judgment subject to appeal in this case, the Illinois General Assembly passed Public Act 85-14, authorizing the State Treasurer to transfer monies from the protest fund to the State's General Revenue Fund, citing the instant lawsuit by name, and providing that "[i]f a final nonappealable order of a court of competent jurisdiction declares [the Act being challenged in this case] void or unconstitutional, the General Assembly shall appropriate" sufficient funds to restore the monies taken from the protest fund created in this case. The repayment provisions relate only to the case at bar. Over the objection of the Goldberg appellants, the Illinois Supreme Court issued an order on August 27, 1987, allowing the Treasurer to transfer some 117 million dollars out of the protest fund, and furthermore allowing transfer of all payments thereafter made into the fund by MCI, AT&T, and Illinois Bell Telephone Company (all of which had agreed to this procedure). GTE Sprint had originally objected to the constitutionality of Public Act 85-14 and the State's motion to withdraw monies from the protest fund, but withdrew its objection in exchange for an agreement that during the pendency of this litigation the State would not seek to withdraw from the protest fund any monies conveyed into it by GTE Sprint.

that the words of the statute "unmistakably mean that the taxable transaction is the interstate phone call" and that "it strains both common knowledge and common sense to characterize an interstate phone call in terms of an Illinois sale at retail and thereby ignore the realities of its interstate participant and the interstate communication system over which it has taken place." GA 20a-21a. The court concluded that the mere fact that the call is charged to an address in Illinois "cannot serve to make local that which is unmistakenly interstate." GA 22a. The court reasoned that the fact that the Legislature had laid its tax on the gross charge for the entire call "makes it clear that the call itself and not its billing in Illinois is what is really being taxed and that event is an interstate activity." GA 21a.

Having determined that Illinois intended to tax interstate commerce, the court then tested the tax by the standards set by this Court. It concluded that the Illinois tax on interstate telecommunications "fails to meet at least three of the four criteria set out in the Supreme Court decision of *Complete Auto* v. *Brady*, 430 U.S. 274." GA 22a. The court held:

> Illinois is attempting to tax the entire cost of an interstate act which takes place only partially in Illinois. This tax by its own terms is not fairly apportioned. It discriminates against interstate commerce and it is not related to services provided in Illinois. [GA 24a.]

"For all these reasons,"[4] the court concluded, "the Act

[4] The Circuit Court also held that the Act violated the Equal Protection Clause, because "it taxes only those who pay for the call and not those whose calls are paid for by others." GA 21a. In addition, the Circuit Court denied a motion by Goldberg and McTigue for class certification. GA 19a. Although it acknowledged that all the prerequisites for class certification were met, the court concluded that a class action was unnecessary because all the monies in dispute were segregated in the protest fund and available for distribution to taxpayers. *See* GA 7a.

must fail." GA 24a.[5]

The state defendants appealed directly to the Illinois Supreme Court. On June 24, 1987, that court issued an order and judgment declaring that the Act was constitutional and reversing the contrary judgment of the Circuit Court. GA 17a. The order stated:

> This announcement is made at this time because of the public importance of this revenue litigation. An opinion setting forth the reasons for the Court's judgment will be completed and filed at a later date. [GA 17a.]

On July 14, 1987, GTE Sprint filed a timely petition for rehearing, urging the Illinois Supreme Court to reconsider its as-yet-unexplained judgment in light of two new decisions of this Court issued the day before that judgment, *American Trucking Associations, Inc.* v. *Scheiner*, 107 S.Ct. 2829, and *Tyler Pipe Industries, Inc.* v. *Washington State Department of Revenue*, 107 S. Ct. 2810.

On July 27, 1987, the four members of the Illinois Supreme Court who participated in the case issued a *per curiam* opinion with respect to the prior judgment. GA 4a. The court began by addressing the State's principal argument on appeal—that section 4 does not tax "the interstate telecommunication itself," but is merely a "retail tax" on the local "purchase of an interstate telecommunication." GA 7a. In rejecting this contention, the court agreed with the Circuit Court that "the fact that section 4 establishes the purchase price of an interstate telecommunication as the basis upon which the tax is calculated does not transform the taxable event into a retail purchase * * *." GA 9a. Instead, the court concluded that

> it is clear that the taxable event is linked inextricably to interstate activity—interstate communication. A person simply cannot make or receive an

[5] The Act provides that "[i]f Section 4 * * * is declared unconstitutional or invalid, no part of this [Act] shall be effective." Ill. Rev. Stat. ch. 120, ¶ 2021; GA 47a.

> interstate telecommunication without activating and participating in a complex network of interstate transmissions culminating in interstate communication. * * * The very process of interstate telecommunication is interstate commerce. [GA 9a.]

Contrary to the Circuit Court, however, the court below held that this state tax on interstate telecommunications did not impermissibly violate any of the three key requirements of *Complete Auto*—that the tax be "fairly apportioned," that it "not discriminate against interstate commerce," and that it be "fairly related to the services provided by the [taxing] State." [6]

In reaching this conclusion, the court acknowledged that the tax "is not an apportioned tax," since it "applies to the entirety of each and every interstate telecommunication." GA 10a. This caused the court to denominate the tax "constitutionally suspect." GA 11a. According to the court below, however, "[i]f the tax avoids the pitfall of multiple taxation, or the risk of such taxation, it is nondiscriminatory; and, the fact that it is unapportioned is not constitutionally significant." GA 11a.

The court held that there could be no danger of such multiple taxation with respect to interstate calls originated in the State because, by definition, "no other taxing entity" could levy a tax on "the origination of an interstate telecommunication in Illinois." GA 11a. With respect to calls received in Illinois, however, the court believed that the Illinois tax *did* present "a real risk of multiple taxation." GA 12a. Indeed, the court noted that the record revealed that at least two jurisdictions outside Illinois already taxed such calls. The court acknowledged that "[c]learly, this is multiple taxation of the same interstate taxable event which would be prohibited by the commerce clause, as interpreted by *Complete Auto* and its

[6] *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 279 (1977). There is no dispute that the first prong of the *Complete Auto* test—that the tax be "applied to an activity with a substantial nexus with the taxing state," *id.*—was satisfied in this case.

progeny * * *." GA 12a. The tax was saved from this fate, according to the court below, solely because "section 4 provides a credit against any tax due from a taxpayer who has paid two or more taxes on the same interstate telecommunication." GA 13a.

In light of the foregoing, the court below concluded that the tax was valid even though wholly unapportioned. The court also concluded that the absence of any risk of multiple taxation (because of the credit provision) was sufficient in itself to satisfy the third prong of the *Complete Auto* test—that the tax not discriminate against interstate commerce. GA 13a. The court noted, furthermore, that "the tax does not discriminate in favor of intrastate telecommunications" since "the same 5% levy" is imposed on both interstate and intrastate communications. GA 11a.

Turning finally to the fourth prong of the *Complete Auto* test, the court held that the tax was fairly related to benefits provided by Illinois. The court recognized that "the State is taxing the 'gross charge' of the entire telecommunication even though the benefits it affords are limited to that portion of the communication occurring within the State." GA 13a. The court concluded, nevertheless, that "the benefits afforded by other States in facilitating the same interstate telecommunication are too speculative to override the substantial benefits extended by Illinois." GA 13a. Accordingly, having found that the tax met all the requirements of the Commerce Clause, the Illinois Supreme Court reversed the Circuit Court's decision and sustained the tax.[7]

[7] The court also reversed the Circuit Court's holding that the Act violated the Equal Protection Clause. GA 14a-16a. Although appellants continue to believe that the Circuit Court was correct on this point, we have not sought review of that question by this Court.

In light of the ruling by the court below on the merits, the court vacated as moot the Circuit Court's order denying class certification. GA 16a. No issues regarding class certification are before this Court.

SUMMARY OF ARGUMENT

This Court has long been committed to the proposition that the States may tax interstate commerce and thereby require it to pay its "just share" of the cost of state services. *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. at 279 (citing *Western Live Stock* v. *Bureau of Revenue*, 303 U.S. 250, 254 (1938)). But the Court has also made clear that if the States do elect to tax interstate commerce, they must assure that it will not pay *more* than its "just share." To provide that assurance, state statutes taxing interstate commerce must comply with three requirements: (1) they must be structured to prevent the possibility that interstate commerce will be taxed more than once on its full value; (2) they must not discriminate against interstate commerce in favor of intrastate commerce; and (3) they must impose a tax which is measured in some fair relation to the extent of the State's contact with the interstate commerce. *American Trucking Associations, Inc.* v. *Scheiner*, 107 S. Ct. at 2839, 2841; *Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609, 626, 629 (1981); *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. at 279. Here Illinois has levied a tax on interstate communication which violates all three of these constitutional requirements.

At the outset, the State insists that it has not taxed interstate commerce at all, but rather has taxed only the "local" purchase of calls in Illinois. This is "mental gymnastics" of the kind disapproved by this Court in *Nippert* v. *City of Richmond*, 327 U.S. 416, 423 (1946). As both lower courts found, the language and practical effect of Illinois' statute makes unmistakable that it has taxed the *entire value* of interstate communications that, by definition, occur only partly within the State.

By laying its tax on the entire value of interstate communications, Illinois has violated the first key constitutional requirement for the tax—that it be "fairly apportioned" in order to avoid multiple taxation of the communications. If Illinois may tax 100 percent of the value of those interstate communications—even though part of the communications are necessarily attributable to activities in other States—there is no sound basis upon which to deny those other States the same right also to tax the same commerce at its full value. The inevitable result would be to permit the commerce to be burdened with multiple taxation.

Contrary to the lower court's view, nothing in Illinois' credit provision prevents this multiple taxation from occurring. At most, that provision permits an individual Illinois taxpayer—who has already paid Illinois' unapportioned tax—to seek a credit when that same taxpayer is taxed again on a given communication. The provision does nothing to prohibit other States from laying their own taxes on other persons who participated in the *same* communication; and it certainly offers no credit in such circumstances. Indeed, if Illinois' rule is adopted, repeated taxation of all forms of interstate communication would not only be authorized but encouraged, producing the precise economic dislocations the Commerce Clause was designed to prevent. To cure this constitutional violation, Illinois should be required to apportion its tax on interstate communications—just as other States are now doing—and to let retailers bill consumers for the particular tax each participating State chooses to levy on its proportionate share of each communication—as GTE has shown retailers have the capability to do.

Even if Illinois' credit provision were sufficient to legitimate its unapportioned tax on interstate communications, that provision cannot rectify Illinois' decision to lay the same five percent tax on interstate and intrastate communications alike. Although applying the same five percent rate appears facially neutral, in effect it is discriminatory because greater in-state services are necessarily provided to the intrastate than the interstate com-

munications. Charging the same rate for lesser services is the economic equivalent of charging a higher rate for the same services. In either case, unconstitutional discrimination against interstate commerce is the result.

Finally, Illinois' decision to charge a constant five percent rate on the full price of interstate communications—no matter what proportionate part of the communications occurs in Illinois or what amount of services Illinois has rendered to facilitate the communication—violates this Court's third important constitutional requirement: that Illinois measure its tax in some fair relation to the services it has provided in connection with the interstate commerce. Far from meeting this requirement, Illinois' statute in fact imposes a tax which is *inversely* related to the services the State has rendered. Thus, the *greater* the total distance traveled by the interstate communication—and thus the *lesser* Illinois' proportionate contribution to and contact with the communication—the *higher* will be Illinois' tax. This will necessarily be so because the constant five percent rate causes the Illinois tax to rise with the price of the communication, even as Illinois' proportionate contribution to the communication falls. In effect, therefore, as the price of a given communication rises (due to its increased interstate transmission), Illinois taxes for itself services provided by other States.

While the lower court excused this violation on the ground that the services provided by other States are "too speculative to override the substantial benefits extended by Illinois," this excuse should not be accepted. The components of interstate phone calls (origination, transmission, and receipt) and the services associated with those components are certaintly not speculative; they are documented and well known. Furthermore, inasmuch as Illinois taxes calls whether it is the originating *or* receiving State, it cannot be said that whatever services are rendered by other States to facilitate those calls do not justify taxation. If this is true, then the services

provided by Illinois must (at least in some cases) likewise be too speculative to justify taxation. Indeed, Illinois' reasoning is simply another invitation for multiple taxation: for if Illinois (as originating *or* receiving State) can tax the full value of a given communication on the ground that the State at the other end has rendered only speculative services, that other State can with equal right make the same claim and levy the same tax.

ARGUMENT

I. The Act Imposes A Tax On Interstate Telecommunications

Throughout this litigation—both in the Circuit Court, again in the Illinois Supreme Court, and most recently in its Motion to Affirm filed in this Court—the State's primary contention has been that no tax has been laid on interstate commerce at all. The State has consistently argued that only "local events" have been taxed by Illinois.[8] This Court long ago admonished the lower courts to be skeptical of such efforts to exempt state taxes from the dictates of the Commerce Clause. As the Court held in *Nippert* v. *City of Richmond*, 327 U.S. at 423:

> If the only thing necessary to sustain a state tax bearing upon interstate commerce were to discover some local incident which might be regarded as separate and distinct from "the transportation or inter-

[8] Thus, in its Motion to Affirm the State contended that the sole "taxable event" under the Act is "the origination or receipt in Illinois of a telephone call—singularly local events," and that the Act is limited to "the taxpayer's activity in Illinois." Motion to Affirm at 5, 15.

The court below made note of the State's repeated efforts to recast the statute as a purely local tax: "[T]he Director has applied various designations to the tax in issue. For example, the tax has been denominated as a 'purchase tax,' 'a use tax, *i.e.*, use of [a] privilege,' 'a tax on the privilege or act of using telecommunications within this State,' 'a consumption tax,' and a tax on the 'act, or * * * privilege of consuming messages.'" GA 8a-9a.

course which is" the commerce itself and then to lay the tax on that incident, all interstate commerce could be subjected to state taxation and without regard to the substantial economic effects of the tax upon the commerce. For the situation is difficult to think of in which some incident of an interstate transaction taking place within a state could not be segregated by an act of mental gymnastics and made the fulcrum of the tax. * * * [T]here is no known limit to the human mind's capacity to carve out from what is an entire or integral economic process particular phases or incidents, label them as "separate and distinct" or "local," and thus achieve its desired result.

Consistent with *Nippert*, both lower courts flatly rejected the "mental gymnastics" which would be necessary to make this tax a purely "local" one; instead, looking to the language of the statute and to its practical effects, those courts found that the Legislature clearly intended—and unquestionably achieved—a tax on interstate commerce. Examination of the statute leaves no doubt that the courts were correct. Section 4 of the Act provides that

> A tax is imposed upon the act or privilege of originating in this State or receiving in this State interstate telecommunications by a person in this State at the rate of 5% of the gross charge for such telecommunications purchased at retail from a retailer by such person. [GA at 29a.]

As the Act states, the five percent tax is levied on the "gross charge" for interstate telecommunications originated or received in Illinois. Section 2(a) in turn defines that "gross charge" as "the amount paid for the act or privilege of originating or receiving telecommunications in this State *and for all services and equipment provided in connection therewith* * * *." GA 25a (emphasis supplied). As both the trial court and the court below recognized, the "services and equipment provided in connection" with the telecommunication necessarily

include services and equipment being provided *outside* the State of Illinois. Thus, the trial court determined:

> Those words [of Section 4] unmistakably mean that *the taxable transaction is the interstate phone call.* * * * *
>
> [I]t is the phone call which is taxed and not the sale or purchase of that call.
>
> Five percent of the *gross charge* makes it clear that the call itself and not its billing in Illinois is what is really being taxed and *that event is an interstate activity.*
>
> In an attempt to tax some local aspect of an interstate phone call, the state asks the Court to focus on one-half of what goes on during that event, that is, the originating or receipt of a phone call to or from out of state, and then the state seeks to combine that half of a transaction with the billing of the same so as to make the entire transaction an Illinois transaction.
>
> The bill, of course, reflects the other out-of-state half of the transaction and in taxing five percent of the *entire* bill it's apparent that *the state is taxing activities which take place outside of Illinois.* [GA 20a-21a (emphasis supplied).]

As indicated above, the Illinois Supreme Court agreed with this analysis. Thus, when the State attempted to argue on appeal that what the Act taxes is a "purchase" in Illinois of a long distance telephone call, the Illinois Supreme Court expressly rejected such an interpretation:

> Thus, the fact that section 4 establishes the purchase price of an interstate telecommunication as the basis upon which the tax is calculated does *not* transform the taxable event into a retail purchase which, by definition, is local, apportioned, nondiscriminatory and fairly related to services provided by Illinois as required by *Complete Auto.* * * * A person simply cannot make or receive an interstate telecommunication without activating and partici-

> pating in a complex network of interstate transmissions culminating in interstate communication. We believe that such interstate communication *is* interstate commerce. The very process of interstate telecommunication is interstate commerce. [GA 9a (emphasis supplied).]

In so ruling, the court below recognized what this Court has held for more than a century—that a tax on the *entire cost* of an interstate telecommunication is necessarily a tax on interstate activity itself. *Telegraph Co.* v. *Texas*, 105 U.S. 460 (1881); *Fisher's Blend Station, Inc.* v. *Tax Commission*, 297 U.S. 650, 654 (1936) ("sending telegraph or telephone messages across state lines * * * is interstate commerce"). This construction of the Act by the lower court is clearly correct and should be affirmed by this Court.[9]

II. The Tax Is Completely Unapportioned And Necessarily Subjects Interstate Commerce To Multiple Taxation

Having determined that the Act lays a tax on "the entirety of each and every interstate telecommunication," it was inevitable that the lower court would also determine that the Act does not meet the "fair apportionment"

[9] Of course, the "practical effect" of the Illinois statute—not its language—ultimately governs its constitutionality, and that effect is for this Court finally to determine. *See, e.g., American Trucking Associations, Inc.* v. *Scheiner*, 107 S. Ct. at 2841; *Maryland* v. *Louisiana*, 451 U.S. 725, 726 (1981); *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. at 279, 281. Nevertheless, in determining that practical effect—particularly in deciding whether the statute's effect is to tax the *whole* of interstate telecommunications rather than a purely local incident thereof—this Court should be guided by the lower courts' determination that the statute was intended by the Illinois Legislature to tax the *whole* of the interstate commerce at issue. The latter determination is a question of state law on which the Illinois Supreme Court's decision is dispositive. *Hortonville Joint School District No. 1* v. *Hortonville Education Association*, 426 U.S. 482, 488 (1976) ("We are, of course, bound to accept the interpretation of Wisconsin law by the highest Court of the State").

requirement of *Complete Auto*. GA 10a. Indeed, far from being a fairly apportioned tax, the lower court was forced to acknowledge that the tax at issue "is not an apportioned tax" at all. GA 10a.

This determination should have led the lower court to reject the tax. As this Court's cases have long made clear, if one State may permissibly tax more than its proportionate share of an interstate commercial activity, so too may all other States with a sufficient nexus with that activity. The inevitable result would be to subject the interstate activity to multiple taxation—taxation that intrastate activity would be spared.

Thus, as this Court stated in *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U.S. 434 (1979):

> It is a commonplace of constitutional jurisprudence that multiple taxation may well be offensive to the Commerce Clause. In order to prevent multiple taxation of interstate commerce, this Court has required that taxes be apportioned among taxing jurisdictions, so that no instrumentality of commerce is subjected to more than one tax on its full value. *The corollary of the apportionment principle, of course, is that no jurisdiction may tax the instrumentality in full.* [*Id.* at 446-447 (emphasis supplied) (citations omitted).]

The Court has frequently reiterated this apportionment requirement,[10] and has applied it in circumstances much like the present case.

For example, the Court recognized in *Western Live Stock* v. *Bureau of Revenue*, *supra*, that:

> A tax on gross receipts from tolls for the use by interstate trains of tracks lying wholly within the

[10] *See, e.g., Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425, 444 (1980) ("Taxation by apportionment and taxation by allocation to a single situs are theoretically incommensurate"); *Exxon Corp.* v. *Department of Revenue of Wisconsin*, 447 U.S. 207, 230 (1980).

taxing state is valid, *New York, L.E. & W.R. Co.* v. *Pennsylvania*, 158 U.S. 431; *cf. Henderson Bridge Co.* v. *Kentucky*, 166 U.S. 150, although a like tax on gross receipts from the rental of railroad cars used in interstate commerce both within and without the taxing state is invalid. *Fargo* v. *Michigan, supra.* In the one case the tax reaches only that part of the commerce carried on within the taxing state; in the other *it extends to the commerce carried on without the state boundaries, and, if valid, could be similarly laid in every other state in which the business is conducted.* [*Id.* at 257 (emphasis supplied).]

Similarly, in *Central Greyhound Lines* v. *Mealey*, 334 U.S. 653 (1948), the Court struck down New York's unapportioned tax on the gross charge for a bus trip which originated and terminated in New York, but which also passed through New Jersey and Pennsylvania:

> If New Jersey and Pennsylvania could claim their right to make appropriately apportioned claims against that substantial part of the business of appellant to which they afford protection, we do not see how on principle and in precedent such a claim could be denied. This being so, to allow New York to impose a tax on the gross receipts for *the entire mileage*—on the 57.47% within New York as well as the 42.53% without—would subject interstate commerce to the unfair burden of being taxed as to portions of its revenue by States which give protection to those portions, as well as to a State which does not. [*Id.* at 662 (emphasis supplied).]

Likewise, in *Michigan-Wisconsin Pipe Line Co.* v. *Calvert*, 347 U.S. 154 (1954), the Court addressed an attempt by Texas to tax the "first taking" of the total volume of natural gas into an interstate pipeline for interstate transmission, a situation much like the "origination" of interstate telecommunications in the case at bar. The Court once again declared that no State may constitutionally arrogate to itself the power to tax the total value of an interstate transmission:

> [F]or if Texas may impose this "first taking" tax *measured by the total volume of gas so taken*, then Michigan and the other receipient states have at least *equal* right to tax the first taking or "*unloading*" from the pipeline of the same gas when it arrives for distribution. Oklahoma might then seek to tax the first taking of the gas as it crossed into that State. The net effect would be substantially to resurrect the customs barriers which the Commerce Clause was designed to eliminate. [347 U.S. at 170 (emphasis supplied).]

The court below ignored the teachings of all these cases and simply declared that "[a]n unapportioned tax * * * is not necessarily invalid," but is merely "constitutionally suspect because of the risk of multiple taxation." GA 10a, 11a. Even if a wholly unapportioned tax could be sustained on the ground that no "risk of multiple taxation" existed—a result that is without precedent in this Court's decisions [11]—that risk is clearly presented by the

[11] The court below could cite no case in which this Court has upheld a wholly unapportioned tax on interstate commerce. Ironically, the sole authority upon which the court below relied for the proposition that "An unapportioned tax, however, is not necessarily invalid" (GA 10a)—*Wisconsin Telephone Co.* v. *Wisconsin Department Of Revenue*, 125 Wis.2d 339, 371 N.W.2d 825 (1985)—was a Wisconsin appellate court decision that placed principal reliance on two cases, the reasoning of which has been rejected by this Court. The *Wisconsin Telephone* case relied upon an Alaska case—*Douglas* v. *Glacier State Telephone Co.*, 615 P.2d 580 (1980)—which, although decided three years after this Court's decision in *Complete Auto*, made its Commerce Clause analysis without so much as a citation to *Complete Auto*. *Douglas* rested its analysis, *inter alia*, on the assumption that a taxpayer had to show a "tangible likelihood" that multiple taxation would result, *id.* at 587; four years later, this Court rejected such a test in *Armco Inc.* v. *Hardesty*, 467 U.S. 638 (1984). The other case principally relied on by the *Wisconsin Telephone* court was *General Motors Corp.* v. *Washington*, 377 U.S. 436 (1964), which was expressly overturned last term in *Tyler Pipe Industries, Inc.* v. *Washington State Department Of Revenue*, 107 S.Ct. at 2816-17.

unapportioned tax in this case. Although the court below offered two reasons why it thought Illinois had successfully removed the risk of multiple taxation, neither reason is valid.

First, with respect to interstate calls *originated* in Illinois, the lower court concluded there was no risk of multiple taxation because it believed that "no other taxing entity could levy a tax on this taxable event." GA 11a. It is not certain what the court meant by this. If the court meant that no other State could tax the isolated act of originating a call in Illinois, that may be so; but it is plainly irrelevant, for that is not what Illinois has done. As the court below itself expressly and correctly determined, "the instant tax applies to *the entirety* of each and every interstate telecommunication"—not merely to origination—and for that very reason "it is not an apportioned tax." GA 10a (emphasis supplied). If, on the other hand, the court meant that no other State could tax any part of calls which originate in Illinois, it was clearly wrong.

It is certain that for every interstate call originating in Illinois, at least one other State (the receiving State) has a sufficient nexus with that call to impose a tax on its proportionate share of the call.[12] Indeed, in the case of a conference call occurring in several areas of the country at once, a call originated in Illinois would be taxable by a number of different States. And if any *one* of those States were permitted to tax the entire unapportioned value of the call—which is what Illinois seeks in this case—no principled basis would exist for denying that right to *every* other State involved with the call. It is this fact which presents the inevitable risk of multiple taxation; which condemned the nearly identical taxes described in *Central Greyhound*, *Western Livestock*, and *Michigan-Wisconsin Pipeline*; and which should have condemned the tax in this case. The court below was simply wrong to suppose that no other State could tax calls originated in Illinois and that this "fact" excused Illinois' failure to meet the "fair apportionment" requirement of *Complete Auto*.[13]

The court below was also wrong in its second asserted justification for this unapportioned tax, *i.e.*, that the Illinois credit provision effectively prevents any multiple taxation of interstate communications. According to the lower court, in the case of Illinois' "tax levied on the reception * * * of an interstate telecommunication," there is "a real risk of multiple taxation" because "at least two taxing jurisdictions [Wheat Ridge and Greeley, Colorado] levy a tax similar to the instant tax * * *." The court concluded that "[c]learly, this is multiple taxation * * * prohibited by the commerce clause, as inter-

[12] Whether or not other States are in fact now taxing calls that originate in Illinois is not constitutionally relevant. The risk of multiple taxation, not the fact, is sufficient to preclude a wholly unapportioned tax such as the present one. Otherwise, as the Court has specifically held, the constitutionality of each State's tax laws "would depend on the shifting complexities of the tax codes of 49 other States, and * * * the validity of the taxes imposed on each taxpayer would depend on the particular other States in which it operated." *Armco Inc.* v. *Hardesty*, 467 U.S. at 644. *See Tyler Pipe Industries, Inc.* v. *Washington State Department of Revenue*, 107 S.Ct. at 2820. Moreover, even if other States chose to "forego * * * entirely" their right to tax the value of interstate calls occurring within their borders, this would not authorize Illinois to tax the entirety of that value for itself. *Cf. American Trucking Associations, Inc.* v. *Scheiner*, 107 S. Ct. at 2840 n. 15; *Central Greyhound Lines, Inc.* v. *Mealey*, 334 U.S. at 663 ("even if neither Pennsylvania nor New Jersey sought to tax their proportionate share of the revenue from [the interstate commerce], such abstention would not justify the taxing by New York of the entire revenue").

[13] The Act itself demonstrates that States other than the State of origination can levy a tax on interstate telecommunication, for Illinois also levies its tax on calls that originate elsewhere and are received in Illinois, so long as the call is charged to an Illinois address. Ill. Rev. Stat. ch. 120 ¶ 2004; GA 29a.

preted by *Complete Auto* and its progeny * * *." GA 12a. Nevertheless, the court reasoned that the Illinois tax escaped this constitutional prohibition because "section 4 provides a credit against any tax due from a taxpayer who has paid two or more taxes on the same interstate telecommunication." This credit provision, the court held, "cures *any possible constitutional infirmity* resulting from the multiple taxation." GA 13a (emphasis supplied). As we will show, the credit provision does not—and could not—accomplish the necessary cure.

At the outset, the lower court significantly understated the number of interstate communications the credit provision would need to protect from multiple taxation in order to save Illinois' unapportioned tax. It is clear the court thought that, at most, only calls *received* in Illinois would need the protection of the credit provision.[14] But, as we have shown—and as the court's own opinion elsewhere makes clear—the Illinois tax is levied on the *entirety* of all interstate calls charged to an Illinois address, regardless whether the calls are originated or received in the State. Accordingly, other States participating in *all* such calls have a right to tax those calls.[15] As a result, even under the lower court's own standard, Illinois' unapportioned tax on such calls must be struck down unless the credit provision in fact prohibits multiple taxation on any of them. While it is difficult to

[14] Indeed, the language of the court's opinion suggests that it may have thought the credit provision was triggered only in the case of taxes on the event of *receipt* of calls in Illinois, as opposed to taxes on *calls* received in Illinois. See GA 12a. Whichever view the court took, its analysis was too restrictive.

[15] The lower court may have limited its credit analysis to calls *received* in Illinois because those calls were the only ones specifically shown to be the current subject of multiple taxation. If that was the rationale for the court's limitation, it was in error; as previously discussed, a statute which *permits* multiple taxation is constitutionally prohibited whether or not such multiple taxation has in fact already occurred. *See* n. 12, *supra*.

imagine how *any* credit provision could achieve that purpose, for several reasons it is patent that the one at bar does not.

The first and most significant failure in Illinois' credit provision is that by its very terms it does not protect *interstate commerce* from multiple taxation at all; instead, the statute is narrowly drawn to protect only *Illinois taxpayers*. At most, the Act affords a credit to an Illinois taxpayer only where that taxpayer has already paid Illinois' unapportioned tax on a given call, and is thereafter legitimately assessed an additional tax by another State or States on the same call. Ill. Rev. Stat. ch. 120, ¶¶ 2004 and 2002(h); GA 29a-30a, 27a. Thus, the credit provision has *no application whatever* where other States choose to tax their own taxpayers for calls they exchange with Illinois' taxpayers.

Accordingly, if such a narrow credit provision were held sufficient to validate this unapportioned tax, the necessary implication would be that the full, unapportioned value of interstate communications may be repeatedly taxed by successive States, so long as each State taxes a different participant involved in the communication. For example, in the case of a conference call involving a dozen participants in a dozen different States, under the lower court's decision each State would be invited to lay a tax on the full value of the call on the participant within its borders. Thus, far from *negating* the possibility of multiple taxation, the lower court's decision—if upheld—would *encourage* such taxation.

Obviously, the underlying assumption in the lower court's analysis of the credit provision is that multiple, unapportioned taxation of a single *interstate activity* is permissible, so long as no single *taxpayer* is taxed more than once. This assumption is clearly fallacious. This Court's Commerce Clause cases are concerned with whether *interstate commerce* has been permissibly taxed,

not with who ultimately pays the tax. *See, e.g., Evansville-Vanderburgh A.A. Dist.* v. *Delta Airlines, Inc.*, 405 U.S. 707, 714-715 (1972) ("Our inquiry is whether the use of airport facilities occasioned by enplanement is a permissible incident on which to levy * * * fees, regardless of whether the airline or its passengers bear the formal responsibility for their payment"); *Bacchus Imports, Ltd.* v. *Dias*, 468 U.S. 263, 268 n.8 (1984) ("Our cases make clear that discrimination between in-state and out-of-state goods is as offensive to the Commerce Clause as discrimination between in-state and out-of-state taxpayers"); *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U.S. at 447 (apportionment required to ensure that "no *instrumentality of commerce* is subjected to more than one tax on its full value") (emphasis supplied).

The reason the Court has repeatedly indicated that it is the commerce which the Constitution protects from multiple taxation—not particular taxpayers—is that regardless of which taxpayers bear the ultimate economic cost of multiple taxation on such commerce,[16] the economic effect will be the same.[17] Here, for example, the inevitable effect of repeated taxation would be to raise the cost of interstate calls relative to intrastate calls and thereby unfairly burden interstate commerce.[18] As the

[16] As noted, Illinois requires long-distance carriers to remit any tax due from the taxpayer, whether or not the taxpayer actually pays the tax. No credit is provided such a carrier even if it pays an additional tax to another State.

[17] This Court has repeatedly recognized that the overall "economic effect" of a State's tax is the appropriate focus. *See, e.g., Westinghouse Electric Corp.* v. *Tully*, 466 U.S. 388, 404 (1984).

[18] As Professor Samuelson has noted, the imposition of a tax on any commodity "will raise the price to consumers and lower the price received by producers, the difference going to government. At the higher price a smaller quantity will be bought by consumers." P. Samuelson, *Economics*, p. 366 (11th ed. 1980). Accordingly, once any new tax has been levied on interstate calls—a tax to which intrastate calls are not subjected—it will inevitably

Court reiterated in *Armco Inc.* v. *Hardesty*, "'[i]f another State has taxed *the same interstate transaction*, the burdensome consequences to interstate trade are undeniable.'" 467 U.S. at 645 n.8 (emphasis supplied) (quoting *Freeman* v. *Hewit*, 329 U.S. 249, 256 (1946)).[19]

Moreover, it would be difficult to overstate the total "burdensome consequences" and economic dislocations that could result if the Court affirms the unapportioned tax in this case. Much more is involved here than a single State's tax on interstate telephone calls.[20] If Illinois is permitted to lay an unapportioned tax on interstate calls so long as it protects *its own* taxpayers from repeated taxes, so too can the other 49 states. Furthermore, the authorized unapportioned taxes in the 50 states would not be limited to telephone calls. As the statute in this case demonstrates, approval of the present unapportioned tax invites similar taxes on the limitless variety of communications that are now, and will be, criss-crossing this country, including:

> messages or information transmitted through use of local, toll and wide area telephone service; private line services; channel services; telegraph services; tele-typewriter, computer exchange services; cellular

follow that fewer and/or shorter interstate calls will be made, that the quality of interstate service will be jeopardized as carriers seek ways to compensate for the reduction in revenues, and that intrastate communications will have been effectively subsidized.

[19] This Court long ago recognized that "where the burden of a tax falls on a thing which is the subject of taxation the tax is to be considered as laid on the thing rather than on him who is charged with the duty of paying it into the treasury." *Telegraph Co.* v. *Texas*, 105 U.S. 460, 465 (1881). The Circuit Court was clearly correct, therefore, when it held that "[t]he relevant inquiry is as to just *what* is being taxed and not *who* is being taxed. * * *." GA 21a (emphasis supplied).

[20] And, as previously stated (see n.2), the telephone tax in Illinois alone, limited to the period since August 1, 1985, had already generated 142 million dollars as of July 1987.

mobile telecommunications service; specialized mobile radio; stationary two-way radio; paging service; or any other form of mobile and portable one-way or two-way communications; or any other transmission of messages or information by electronic or similar means, between or among points by wire, cable, fiber-optics, laser, microwave, radio, satellite or similar facilities. [Ill. Rev. Stat. ch. 120, ¶ 2002; GA 26a.]

If every State were permitted to charge a tax on the full value of all such forms of interstate communication to every in-state taxpayer who participated in the communication, the possibilities for cumulative multiple taxation would be staggering; taxes in excess of the underlying charge for the communication services would not be far-fetched at all. As this Court stated in *Armco*, the "burdensome consequences"—particularly to this burgeoning area of interstate commerce—would be "undeniable." 467 U.S. at 645 n.8.

Moreover, if this Court approved a State's unapportioned tax on the basis of a credit provision like the one in this Act—which effectively offers to transfer the *entire* tax on a given interstate communication to any other State laying an equal or greater tax on the same taxpayer—the result would be to award the whole of the tax on interstate commerce to a single State, even though several States may have contributed to the commerce. This directly undermines the "fair apportionment" standard *Complete Auto* and its progeny were designed to foster.

Finally, even if the Court were otherwise inclined to uphold an unapportioned tax where a credit provision guaranteed that no single *taxpayer* would be subjected to multiple taxation, Illinois' credit provision presents no such guarantee. The tax-and-credit scheme provided for here is fundamentally different from the normal situation where a taxpayer obtains a credit against another tax, such as in the case of use and sales taxes. In those situa-

tions, the taxpayer himself has paid the tax and knows that the first tax has been paid when he is called upon to pay the second tax. Moreover, in those situations, the taxpayer is not required to pay the second tax in full and then seek to obtain a "credit"; rather, the second tax is simply reduced by the amount of the first at the time the second tax is paid. *Compare American Trucking Associations, Inc.* v. *Scheiner*, 107 S. Ct. at 2834-35.

In the case at bar, however, there is not even an absolute requirement that the taxpayer be informed of the amount of tax imposed on him by this Act,[21] much less any assurance that he will know of a tax imposed by *another* State on the same call. And when the taxpayer pays the tax under this Act, he pays it *not* to the party from whom he must later attempt to obtain the "credit" (the State), but rather to the long distance carrier. When all of this is considered in the context of the fact that the Act contains no procedures whatever for actually obtaining the "credit," Illinois' taxing scheme should be deemed so ineffective and burdensome as not to meet the demands of the Commerce Clause. *Cf. Nippert* v. *City of Richmond*, 327 U.S. at 430 n.21. This should particularly be so where, as here, the State has sought to justify an otherwise unapportioned, unconstitutional tax on the ground that its credit provision assures that no multiple tax can possibly result. Illinois' credit scheme does not offer any such assurance.

For all the foregoing reasons, the existence of the "credit" referred to in Section 4 of the Act cannot remove the risk—indeed the likelihood [22]—of multiple taxa-

---

[21] The Act provides only that it be disclosed "[w]henever possible." Ill. Rev. Stat. ch. 120, ¶ 2005; GA 30a.

[22] The subject of interstate telecommunications taxation has become a principal focus of taxing authorities throughout the country, and it is clear that taxes on interstate telecommunications—of all sorts—will proliferate as State and local taxing

tion that results from Illinois' imposition of an unapportioned tax on interstate commerce. It bears emphasis that the dispute does not center on whether an apportionment by Illinois of that portion of the transaction fairly allocable to Illinois has been fairly calculated. We understand that "extreme nicety is not required" in making this allocation,[23] but here Illinois has made *no attempt*

---

authorities intensify their search for new sources of revenue. *See, e.g., The Taxation Of Telecommunications: In Ohio,* NATA Conference on Revenue Estimating, November 1-4, 1987; *Unitary Method, Florida Sales Tax, Telecommunications Taxes Focus of FTC Meeting,* 36 Tax Notes, No. 3, p. 249, July 20, 1987; *The Challenge Of Telecommunications: State Regulatory And Tax Policies For A New Industry,* edited by Barbara Dyer, December 15, 1986; *Final Report Of The Connecticut Telecommunications Task Force,* Finance, Revenue and Bonding Committee, Connecticut General Assembly, January 1986; *Florida Telecommunications Task Force Final Report To Governor Bob Graham And The Florida Legislature,* February 1, 1985.

[23] *Smith* v. *Illinois Bell Telephone Co.,* 282 U.S. 133 (1930). In *Smith,* the District Court had found that interstate long distance telecommunication then made up a miniscule percentage of the total use of the local network facilities: one-half of one percent of all originated calls. *Id.* at 147. It therefore had decided that "as a matter of convenience, in view of the practical difficulty of dividing the property between the interstate and intrastate service," such apportionment was not required. *Id.* at 150. This Court unanimously reversed, concluding that whatever the practical difficulties of separating costs, such separations were required to avoid discrimination: "While the difficulty in making an exact apportionment of the property is apparent, and extreme nicety is not required, only reasonable measures being essential, *it is quite another matter to ignore altogether the actual uses to which the property is put.*" *Id.* at 150-151 (emphasis supplied) (citations omitted).

The *Smith* decision still guides the telecommunications industry today. After *Smith,* the States, the FCC, and telephone companies developed standard methodologies for apportioning the costs of property between interstate and intrastate, generally based on relative usage of the specific facilities. These apportionment principles necessarily make use of reasonable assumptions and estimates

whatsoever to fairly apportion the amount of the charge for the communications attributable to services provided by Illinois.

Illinois' action should be contrasted with the approach other States have taken. For instance, Florida has adopted an apportionment formula in its tax on interstate privateline communications "to ensure that no more than 100 percent of the interstate interoffice channel mileage charge can be taxed by this state and another state." Fla. Stat. Ann. § 212.05(1)(e)2c. Similarly, New Mexico provides that its gross receipts tax on interstate telecommunications shall apply to sixty-five percent of receipts from long-distance interstate and foreign calls that either originate or terminate in New Mexico and are billed to a New Mexico account or number. N.M. Stat. Ann. § 7-9-56(C). Likewise, Virginia applies its gross receipts tax on interstate telecommunications on the basis of a comparison of the carrier's circuit capacity in Virginia with its capacity systemwide. Va. Code §§ 58.1-2623 and 58.1-2624. *Cf. South Cent. Bell Telephone Co.* v. *Celauro,* 735 S.W.2d 228 (Tenn. 1987) ("end-user charge" on long-distance calls permitted only because the charge was fairly apportioned to services rendered in Tennessee).

These other States' efforts to avoid multiple taxation of interstate commerce may or may not pass constitutional muster. But at least these States recognize that *some* apportionment effort must be made and that no one State can arrogate to itself the right to tax the entire value of an interstate communication. Illinois, in contrast, wants it all. And inasmuch as Illinois' credit provision fails to remove the threat of multiple taxation and otherwise completely subverts the requirement of "fair

---

which have been adjusted over time as interstate long-distance service has developed from an expensive luxury to a commonplace of modern life. But the core necessity of apportionment of costs has always been observed.

apportionment,"[24] the State's tax cannot be squared with the Commerce Clause. It should therefore be disapproved.

III. The Tax Discriminates Against Interstate Commerce

The lack of apportionment of the Illinois tax "is a form of discrimination against interstate commerce." *Armco Inc.* v. *Hardesty*, 467 U.S. at 644. This is because Illinois' tax subjects interstate calls to multiple taxation that local calls need not bear. Thus, a conference call among twelve Illinois cities will be taxed on its full value only once, at a rate of five percent. As explained above, however, if that conference call were among twelve cities in twelve different States, Illinois' approach invites each State to tax the call on its full value; this could easily produce a cumulative tax in excess of the cost of the call itself.

But that is not the only form of discrimination effected by the challenged tax. Even assuming that a credit provision such as Illinois' could avoid the risk of multiple taxation, that provision cannot absolve the statute from the other kind of discrimination it practices—charging interstate communications at a higher effective rate for services rendered than it charges intrastate communications.

The court below assumed that the Illinois tax did not discriminate against interstate commerce simply because

[24] Significantly, as GTE's uncontradicted evidence demonstrated in the trial court, carriers now have the capability to bill each telephone customer for whatever tax each participating State chooses to levy on its proportionate share of each call charged to the customer's account. "For example, GTE Sprint can bill an Illinois customer for an interstate telecommunication originating in Illinois and terminating in New York, and could include, in that charge, a tax assessed by Illinois, the originating state, and New York, the terminating state." GTE A 9a. In such circumstances, there can be no justification for Illinois' decision to tax the whole of interstate communications, rather than only its fair share.

Illinois taxed interstate and intrastate telecommunications at the same flat rate. GA 11a. As this Court emphasized in a recent opinion, however—an opinion that was not available to the court below when it issued its judgment—"the Commerce Clause has a deeper meaning that may be implicated even though state provisions * * * do not allocate tax burdens between insiders and outsiders in a manner that is *facially* discriminatory." *American Trucking Associations, Inc.* v. *Scheiner*, 107 S. Ct. at 2839 (emphasis supplied). In practice, Illinois' application of the same rate to all telephone calls in fact *ensures* discrimination, since Illinois necessarily provides greater services with respect to intrastate than interstate calls. The net result is that interstate calls are subject to greater taxation for the same services.

A variety of examples illustrates the inherent discrimination. Take two calls from Chicago, one to Joliet, Illinois, and the other to Gary, Indiana. Assume both calls cost two dollars. Each call is taxed ten cents by Illinois. Illinois provides origination, complete transmission, and receipt services for the intrastate call for that ten cents. The interstate call is subject to the same ten-cent tax but receives only origination and partial transmission services from the taxing State for its dime. It therefore pays more for those same services than the intrastate call.

The discrimination is inherent in the statute, since the Act imposes the same tax on interstate calls even though the State necessarily provides fewer services for such calls. This discrimination is more dramatically illustrated by considering a call from Chicago to a town on the western border of Illinois, costing, say, two dollars, and a call from Chicago continuing on from that town on the western border to Los Angeles, costing, say, five dollars. Both calls originate at the same point in Illinois and both are carried the same distance through Illinois. But the intrastate call is taxed ten cents for this service and the interstate call is taxed 25 cents. Because Illinois

imposes a higher charge on interstate calls for the same services (a result attributable to its taxing of activities beyond its borders), the charge necessarily discriminates in favor of purely local activity.

This Court confronted a similar problem in *Scheiner*. There Pennsylvania imposed the same axle tax on all vehicles, whether registered in Pennsylvania or outside the State. The lower court, like the court below here, sustained the tax as nondiscriminatory.[25] This Court reversed, finding that the facially neutral tax discriminated against the vehicles in interstate commerce: "In practical effect, since they impose a cost per mile on appellants' trucks that is five times as heavy as the cost per mile borne by local trucks, the taxes are plainly discriminatory." 107 S. Ct. at 2841.[26] So too here: the imposition by Illinois of the same flat tax on intrastate and interstate telecommunications results in a higher proportional cost being imposed on the interstate telecommunications. Such a result is "plainly discriminatory." [27]

---

[25] *Compare* GA 11a *with* 107 S.Ct. at 2838.

[26] Justice Stevens, who wrote the opinion for the Court in *Scheiner*, anticipated the reasoning adopted in that case when he noted earlier in *Mobil Oil Corp.* v. *Commissioner of Taxes, supra*:

> [I]f, in a particular case, use of [a particular taxing formula] has the effect of taxing income earned by an interstate entity outside the State, it could alternatively be said to have the effect of taxing the income earned by that entity inside the State at a rate higher than that used for a comparable, wholly intrastate business, a discrimination that violates the Commerce Clause. [445 U.S. at 452 (Stevens, J., dissenting).]

The same discrimination is presented here. Because Illinois in effect taxes interstate communications for out-of-state services, its rate of tax for its own in-state services is higher for those interstate communications than for wholly intrastate communications.

[27] Moreover, the less contact Illinois has with a particular interstate call, the more discriminatory its treatment of that call will become. Given that longer interstate calls carry a higher retail charge, the smaller a call's proportional contact with Illinois, the greater will be Illinois' tax. Conversely, in the case of the generally less expensive intrastate calls, where Illinois' contact is exclusive and its services at their apex, the tax will necessarily be less than for interstate calls, due to the constant five percent rate.

Thus, the Illinois tax discriminates against interstate commerce in two ways: first, by subjecting interstate calls to multiple taxation, it burdens those calls with costs that will not be borne by intrastate calls; second, even if no other State imposed a tax on the interstate calls—and hence no multiple taxation ever occurred—Illinois' flat tax on all calls effectively imposes a heavier burden on interstate calls for the same state services. Such discrimination is prohibited by the Commerce Clause.

IV. The Tax Is Not Fairly Related To Services Provided By Illinois

The fourth prong of the *Complete Auto* test requires that the tax on interstate commerce be "fairly related to the services provided by the State." 430 U.S. at 279. The "fair relation" element of the test demands that

> the measure of the tax must be reasonably related to the extent of the contact [with the taxing State], since it is the activities or presence of the taxpayer in the State that may properly be made to bear a "just share of state tax burden." [*Commonwealth Edison Co.* v. *Montana*, 453 U.S. at 626 (quoting *Western Live Stock* v. *Bureau of Revenue*, 303 U.S. at 254).]

Here the measure of the tax is clearly not "reasonably related" to the extent of contact with the taxing State. In fact, the measure is *inversely* related to the extent of contact; *i.e.*, as the contact of the interstate commerce with Illinois diminishes, the tax on that commerce *increases*.[28]

---

[28] The uncontradicted evidence submitted in the trial court established that

> The basic charge for an interstate toll call varies according to the distance between the place the call originates and the

This perverse result is a necessary consequence of the flat five percent tax and the State's decision to allocate to itself the entire value of interstate telecommunications. This Court observed this precise phenomenon forty years ago in setting aside New York's unapportioned gross receipts tax on interstate transportation in *Central Greyhound Lines* v. *Mealey*, *supra*:

> By its very nature, an unapportioned gross receipts tax makes interstate transportation bear more than "a fair share of the cost of the local government whose protection it enjoys." [334 U.S. at 663 (quoting *Freeman* v. *Hewit*, 329 U.S. at 253).]

A simple example will highlight the problem. The tax on a one-dollar call from Chicago to an Iowa town just over the border is five cents. The tax on a five-dollar call from Chicago to Los Angeles—involving proportionally much less contact with Illinois—is 25 cents. As the interstate aspects of the commerce grow, Illinois demands a greater tax based on the proportionally diminishing contact with Illinois. Since the measure of the tax is based on the entire value of the interstate telecommunication—including value attributed to activities outside Illinois—the greater the significance of those out-of-state activities, the higher the tax for the in-state activities. Accordingly, the Illinois tax, like the taxes at issue in *Scheiner*,

> does not vary with miles traveled or with some other proxy for value obtained from the State. "[W]hen the measure of a tax bears no relationship to the taxpayers' presence or activities in a State, a court may properly conclude under the fourth prong of the *Complete Auto Transit* test that the State is imposing an undue burden on interstate commerce." [*Scheiner*, 107 S. Ct. at 2844 (quoting *Commonwealth Edison Co.* v. *Montana*, 453 U.S. at 629).]

place it terminates, increasing in price as the distance between these points increases. The charge for an interstate private line call varies solely according to the length of the line utilized in the transmission. [GTE A 9a.]

The fourth prong of *Complete Auto* simply recognizes that a State may not tax activity outside its borders to which it has no legitimate claim, but must measure its tax in some form relative to the services it has provided.

To the extent that the court below gave any consideration to the fair relation requirement, it did so with reasoning that was internally inconsistent and a clear invitation to multiple taxation. It argued first that the services provided by Illinois "facilitate perhaps the most critical step in the taxable event—interstate origination." It next acknowledged that "[i]t is true that the State is taxing the 'gross charge' of the entire interstate telecommunication even though the benefits it affords are limited to that portion of the communication occurring within the State." The court then concluded that "the benefits afforded by other States in facilitating the same interstate telecommunication are too speculative to override the substantial benefits provided by Illinois." GA 13a.[29] It is not clear whether the court meant that other States' services are "too speculative" only when Illinois is the originating State, or also when it is the receiving

[29] The court below relied on *Western Live Stock* v. *Bureau of Revenue*, *supra*, for its "too speculative" language. *Western Live Stock* involved a tax on the amounts received from the sale of advertising space in a New Mexico magazine with an interstate circulation. The Court noted that the tax was not on the purchase (subscription) price of the magazine but rather on "the preparation, printing and publication of the advertising matter, and the receipt of the sums paid for it"—all of which "occur[red] in New Mexico and not elsewhere." 303 U.S. at 260. The Court thought that the extent to which those advertising rates reflected the interstate circulation was "too remote and too attenuated" to call for apportionment. *Id.* at 259.

In the case at bar the involvement of other States is neither remote nor speculative; it is palpable and admitted: "A person simply cannot make or receive an interstate telecommunication without activating and participating in a complex network of interstate transmissions culminating in interstate communication." GA 9a.

State. Whichever the Court meant, its conclusion is factually incorrect[30] and analytically unsound.

Illinois, of course, taxes the full value of interstate transmissions charged to an Illinois address whether it is the originating or receiving State. If the court meant that only a *receiving* State's services are "too speculative" to justify taxation, then Illinois—which taxes the entire values of calls received and charged in Illinois—cannot justify its own tax on such calls. On the other hand, if the court intended to declare that other States' services are "too speculative" whether Illinois were the originating *or* receiving State, the court has either implicitly condemned *all* of Illinois' taxes in this case or, alternatively, the court's reasoning (if accepted) would constitute a blanket endorsement of multiple taxation. Manifestly, if one State may simply declare that all out-of-state services associated with any given interstate call are "too speculative" to warrant consideration, so too may the other States connected with the same communication; and, accordingly, all such States may tax the entire value of the communication. This is plainly unacceptable.

---

[30] There is nothing "speculative" about the services associated with interstate calls. A typical interstate call has three distinct segments: local originating access in State A, long-distance transmission from State A to State B (perhaps crossing several intermediate States), and local terminating access in State B. Significantly, each of these segments uses separate facilities and involves separate charges, even though the charges are usually bundled together when billed. The local telephone company in State A provides originating access service for the call and bills the long-distance carrier for that service at its tariff rates; the local telephone company in State B similarly provides the terminating access at its own different rates. The long-distance carrier then charges the customer the sum of the originating and terminating access rates plus its own rate for the interstate transmission segment. *See generally NARUC* v. *FCC*, 737 F.2d 1095, 1103-04 (D.C. Cir. 1984), *cert. denied*, 469 U.S. 1127 (1985). GTE Sprint introduced uncontradicted evidence to this same effect in the trial court. GTE A 7a-9a.

In any event, even if the services provided by one State (for example, the originating State) were more substantial than those provided by the receiving State, that fact would not allow Illinois to tax the *full* value of calls originating within its borders. The question is not whether the out-of-state benefits "override" the benefits provided by Illinois; the question, rather, is whether Illinois has devised a tax that fairly measures the benefits that *it* provides. As shown, Illinois has not. Indeed, it has devised no measure at all. The State's complete failure to measure its tax in some fair relationship to the services its provides renders the tax unconstitutional.

CONCLUSION

For the foregoing reasons, the judgment below should be reversed.

Respectfully submitted,

WALTER A. SMITH, JR.*
JOHN G. ROBERTS, JR.
HOGAN & HARTSON
(a partnership including professional corporations)
555 Thirteenth Street, N.W.
Washington, D.C. 20004
(202) 637-6448

JOHN G. JACOBS
JONAH J. ORLOFSKY
PLOTKIN & JACOBS, LTD.
116 South Michigan Avenue
Suite 1300
Chicago, Illinois 60603
(312) 372-0001

Counsel for Appellants

Of Counsel:

WILLIAM G. CLARK, JR.
WILLIAM G. CLARK, JR. & ASSOCIATES, LTD.
29 South LaSalle Street
Chicago, Illinois 60603
(312) 263-0830

* Counsel of Record